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In the Supreme Court of the United States

OCTOBER TERM, 1978

PAULEY PETROLEUM INC., ET AL., PETITIONERS

v.

THE UNITED STATES OF AMERICA, ET AL.,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion of the Court of Claims (Pet. App. A-1 to A-35) is reported at 591 F.2d 1308. The Court of Claims' findings of fact (Pet. App. A-37 to A-40, A-43 to A-334) are unreported.

JURISDICTION

The judgment of the Court of Claims was entered on January 24, 1979 (Pet. App. A-1) and a timely

motion for rehearing was denied on April 6, 1979. The petition for a writ of certiorari was filed on July 5, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTIONS PRESENTED

1. Whether the Department of the Interior breached a lease contract with petitioners, or whether petitioners were injured, when the Department declined to rule on their application to drill an exploratory well in the Santa Barbara channel because petitioners had failed to submit all technical data necessary to enable the Department to review their application following a serious oil spill in the channel, and where petitioners had abandoned any intention of drilling the well soon after they filed their application.

2. Whether this Court should consider whether state law or federal regulations promulgated under the Outer Continental Shelf Lands Act, 43 U.S.C. 1331-1343, govern the liability of a lessee to third parties for damages resulting from an oil spill on the lessee's tract even though the present case does not involve an oil spill on petitioners' leased tracts and resolution of the choice-of-law question would have no bearing on petitioners' substantive claims of breach or frustration of their lease agreement.

STATEMENT

Petitioners are members of a consortium of oil corporations that acquired two oil and gas leases of submerged lands in the Santa Barbara Channel off the coast of California in 1968.[1] The leases were issued by the Department of the Interior pursuant to the Outer Continental Shelf Lands Act of 1953, ch. 345, 67 Stat. 462-471, 43 U.S.C. 1331-1343.

After the leases were acquired, petitioners or their predecessors in interest conducted extensive exploratory drilling operations on the leased acreage. No oil or gas was found in commercially usable quantities in any of the eight exploratory wells drilled by petitioners. The results were discouraging and caused several members of the consortium to express reluctance about further exploratory drilling, to sell their interests or to offer to sell their interests, or to write off a substantial part of their investment by early 1969 (Findings 66(c)-(i), 78(j) and 79, Pet. App. A-221 to A-226, A-328 to A-329, A-330 to A-333).

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[1] At the time this litigation was initiated those companies holding interests in the leases were Pauley Petroleum, Inc., Colorado Oil and Gas Corporation, Mesa Petroleum Company, McCulloch Oil Corporation of California, J. M. Huber Corporation, Husky Oil Company, Midwest Oil Corporation, Kewanee Oil Corporation and Forest Oil Company. Of these only Pauley, Colorado Oil and Gas, Mesa, McCulloch, Huber and Husky initiated the action. The remaining companies were joined as involuntary plaintiffs and, although they adopted the original petitioners' case, did not participate at trial. At this time only Pauley, Colorado Oil and Gas (now Derby Refining Company), Mesa, McCulloch, Husky and MacDonald (now Adobe Oil and Gas Corporation) have petitioned for certiorari.

A major environmental emergency occurred on January 28, 1969, when a well on a nearby tract leased by Union Oil Company of California blew out. The blow-out created a 50-mile square oil slick and coated the shores of Santa Barbara Channel with oil (Pet. App. A-4; Finding 71(a), Pet. App. A-285 to A-286).

The Department of the Interior initiated three programs to cope with the particular disaster and to insure against similar spills in the future. First, engineers and scientists were directed to determine the cause of the blow-out and to stop the flow of oil. Second, another group of experts was assigned to review and, where necessary, modify all relevant regulations and orders. A third group was assigned to review geological and geophysical information on each lease in the Santa Barbara Channel to ascertain if operations could be safely conducted thereon (Finding 72(d), Pet. App. A-291; Findings 75-77, Pet. App. A-302 to A-317). While these efforts were in process, petitioners filed an application on February 11, 1969, to drill a new well on one of their leases (Pet. App. A-6, A-7; Finding 71(b), Pet. App. A-286).

On February 20, 1979, a meeting was held in Washington with oil industry representatives to discuss proposed changes in Outer Continental Shelf (OCS) Orders pertaining to drilling procedures in response to the Secretary's directive that existing regulations and orders be reviewed. Petitioners previously had received copies of the proposed changes, and petitioners' representative commented on the

proposed changes at the meeting (Finding 75(b), Pet. A-303 to A-304).

On February 21, the Secretary published in the *Federal Register* a regulation concerning lessees' responsibility for oil spills occurring on their leases (Pet. App. A-5 to A-6; Finding 75(g), Pet. App. A-306 to A-308).[2] Petitioners apparently interpreted this regulation to impose absolute liability, not only for the costs of cleaning up oil spills, but also for damage caused to third parties (Pet. App. A-6; Finding 78(a), Pet. App. A-317 to A-318).

In furtherance of his directive that technical data pertaining to the Santa Barbara channel be reviewed on a lease-by-lease basis, the Secretary sent a telegram on March 1, 1969, to all lessees of tracts in the channel requesting them to furnish all available geological, geophysical and structural information to the regional supervisor in Los Angeles. The telegram noted that this information was in addition to that required under existing regulations with respect to wells, platforms, and other matters (Finding 77(c), Pet. App. A-312 to A-313).

At a March 12, 1969, meeting of the operating committee responsible for petitioners' operations, most of the members present stated that they would

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[2] The regulation (Pet. App. G) provided that if the high seas are polluted by the drilling or production operations of a lessee in a manner that threatens damage to wildlife or public or private property, "control and removal of the pollutant and the reparation of any damage, to whomsoever occuring, proximately resulting therefrom shall be at the expense of the lessee."

not participate in the drilling of another well as long as the regulation promulgated by the Secretary on February 21 remained in effect. The members also discussed the possibility of filing a lawsuit against the United States. Finally, the members decided that the question of furnishing additional information to the regional supervisor as requested in the March 1 telegram would be held in abeyance pending a decision regarding the proposed lawsuit (Finding 78(a), Pet. App. A-317 to A-319). On March 17, a representative of petitioners wrote the regional supervisor asking him to confirm petitioners' understanding that the additional information requested had to be furnished only if and when they requested another drilling permit on one of their leases. On March 20, the regional supervisor notified petitioners of the nature of the information required under the Secretary's March 1 telegram and confirmed that this additional information would be required only before applications to drill additional wells could be approved (Findings 78(c) and (d), Pet. App. A-320 to A-323).

On March 28, 1969, the Secretary issued OCS Order No. 10 establishing more stringent requirements for casing, cementing, mud drilling, and blowout procedures (Pet. App. A-7; Finding 75(e), Pet. App. A-305 to A-306). This order was issued as part of the review of OCS Orders the Secretary had directed in response to the January 28 oil spill.

On April 9, 1969, petitioners filed the complaint in this action, noting that the Secretary's promulgation

of the February 21 regulation (which they interpreted to impose absolute liability for oil spills) had "rendered it economically and practically impossible" for petitioners to continue further drilling or production operations under their leases (Finding 78(h), Pet. App. A-326 to A-327). However, as the Court of Claims noted (Pet. App. A-17), the February regulation appears to have been under continuous review in the Department of the Interior. In early May, the Department announced a set of proposed amendments to the OCS regulations. These included a proposed new 30 C.F.R. 250.43(b) that restated the substance of the regulation published on February 21. 34 Fed. Reg. 7381, 7383 (May 7, 1969). In response to a number of comments received reflecting confusion about the meaning of that provision, the Department of the Interior promulgated a new 30 C.F.R. 250.43(c) in August providing that the "lessee's liability to third parties, other than for cleaning up the pollutant in accordance with paragraph (b) of this section shall be governed by applicable law. 34 Fed. Reg. 13544, 13547 (August 22, 1969).

Petitioners never submitted all information the regional supervisor stated in his March 20 letter was required to be submitted and never amended their February 11 drilling application to comply with OCS Order No. 10 issued by the Secretary on March 28. Based on this and other evidence, the trial judge found that petitioners did not intend after mid-March to conduct further drilling operations on their leases

because of the issuance of the February 21 regulation "and that this is the reason why they failed to pursue the Department of the Interior's clearance procedures to permit future drilling operations, and why they failed to file an application for a permit to do further drilling in compliance with the requirements of OCS order No. 10" (Finding 78(k), Pet. App. A-329 to A-330). Petitioners did not take exception to this finding.

Petitioners' complaint in the court below alleged four causes of action. In their primary cause of action, they alleged that the Secretary's issuance of the February 21, 1969 regulation concerning the responsibilities of a lessee for oil spills had made it commercially impossible for petitioners to operate under the leases, thereby giving rise to a claim of frustration. The second cause, premised on the same facts as the claim of frustration, was that there had been a mutual mistake of law as to the standard of lessee liability to third parties and that petitioners could rescind the contract as a result. The third cause of action was for breach of contract based on the February 21 regulation, the failure of the Secretary to approve petitioners' February 11 drilling application, and the clearance procedure for reviewing leases on a case-by-case basis, which petitioners characterized as a camouflage for an indefinite suspension of drilling. In the final cause of action, petitioners alleged that the United States had by its actions taken petitioners' leasehold interests. The Court of Claims, after a lengthy trial and receipt of extensive briefs and find-

ings of the Trial Judge, found against petitioners on each count and dismissed their petition. Petitioners do not press their mutual mistake and taking contentions in this Court (Pet. 25 n.* * *).

ARGUMENT

1. Petitioners contend (Pet. 37-46) that the government breached the lease agreement by failing to approve their application for additional drilling filed February 11, 1969, improperly relying on petitioners' failure to comply with the lease-by-lease clearance procedure established by the Secretary in the wake of the January 28 oil spill. This argument, however, is foreclosed by the uncontested finding of fact, quoted above, that petitioners did not intend after mid-March to conduct further drilling operations on their tracts and for this reason failed to pursue the Interior Department's clearance procedures or to file an amended drilling application to comply with the new drilling standards in OCS Order No. 10, issued on March 28, 1969. This finding is fully supported by the record (Pet. App. A-22). Accordingly, petitioners cannot now assert that they were injured by the Department's clearance procedure or by the failure of the Department to approve their drilling application.

Moreover, as the Court of Claims noted (Pet. App. A-25), the serious blow-out at the Union Oil well on January 28 fully warranted a reasonable suspension of drilling in the Santa Barbara Channel pending the gathering and evaluation of additional technical data

about leases in the channel. See also *Sun Oil Co.* v. *United States*, 572 F.2d 786, 802 (Ct. Cl. 1978); Cf. *Gulf Oil Corp.* v. *Morton*, 493 F.2d 141, 146 (9th Cir. 1973).

The Secretary moved expeditiously to establish the mechanism for the review. By March 1, the Secretary had sent telegrams to all lessees in the channel requesting additional information, and by March 28, 1969, the Secretary had issued OCS Order No. 10 establishing more stringent standards for drilling new wells. The lease-by-lease clearance procedure was designed to precede and provide necessary background information for the review of subsequent applications for permits to drill on each lease. The clearance of a particular lease and the approval of an application to drill under that lease could therefore not proceed until the lessee had furnished the information requested in the March 1 telegram (Finding 77(h), Pet. App. A-316 to A-317).

Petitioners did not submit any of the requested data to the regional supervisor until April 4, more than a month after the telegram requesting the data was sent to all lessees, and they never submitted all necessary information to the Interior Department or amended their application to conform to OCS Order No. 10. The record establishes that these failures by petitioners were the reason their February 11 drilling application was not approved (Finding 77(i), Pet. App. A-317).

Petitioners' correspondence with the regional supervisor during this period made no mention of the February 11 application, and instead created the impression that petitioners were only concerned about the need to submit the newly requested information should they choose to submit an application at a later date (Findings 78(c)-(h), Pet. App. A-320 to A-327). And after the present lawsuit was abruptly begun on April 9, 1969—when petitioners alleged that further drilling on their lease was impossible—the Department of the Interior "could rightly assume (particularly since [petitioners] did not indicate otherwise) that the February 11th drilling application was no longer being pressed" (Pet. App. A-26). Because of the court's finding that petitioners did not, and did not intend to, press their February 11 drilling application, they cannot complain of the Department's clearance procedure that was made applicable to lessees who *did* submit new applications or seek to resume operations at existing wells.

In any event, there is no basis for petitioners' contention that the clearance procedure was a bureaucratic facade to conceal a departmental decision to shut down drilling operations altogether. A task force was promptly created to analyze technical data on each leased tract to determine whether production operations shut down by order of the Secretary on February 7 could be resumed and whether exploratory drilling could be conducted safely on other tracts should applications for such drilling be filed (Finding 77(b), Pet. App. A-312). Clearance was granted

by April 1, 1969, to four of the five tracts of other lessees whose production operations had been suspended immediately after the oil spill, and clearance for the fifth lessee was subsequently granted (Pet. App. A-26 to A-27; *Sun Oil Co.* v. *United States*, *supra*, 572 F.2d at 797-800).

Although petitioners now contend (Pet. 41-46) that the Department failed to inform them of what was required to comply with this clearance procedure and that they were injured as a result, the court below expressly found that petitioners *did* promptly learn of the lease clearance requirements and procedures and were informed by the regional supervisor that submission of the additional technical information requested in the Secretary's March 1 telegram was a prerequisite to consideration of drilling applications (Findings 78(b) and (c), Pet. App. A-319 to A-320). Because they had actual notice of these essentials of the lease-by-lease review and drilling application procedures, they have no basis to complain that the Secretary should have published this information. 5 U.S.C. 552(a)(1).

Moreover, the court below further found that Interior officials were prepared to and did contact and meet with other lessees of tracts in the Santa Barbara Channel to explain the clearance procedure in greater detail, to request additional information, and to review information furnished (Finding 77(f), Pet. App. A-314 to A-315). But petitioners did not pursue the clearance procedure or comply with the threshold requirement of submitting complete geological

data, of which they were aware (Pet. App. A-27 to A-28). The reason for this, no doubt, may be found in the Court of Claims' well-supported evidentiary finding that petitioners never intended after mid-March to pursue drilling in the channel.

2. Petitioners also ask the Court to consider whether a lessee's liability for injury to third parties caused by an oil spill on the lessee's tract is governed by state law or federal regulations issued under the Outer Continental Shelf Lands Act (Pet. 3-4, 46-50). However, petitioners present this issue in the abstract, suggesting only that it would be useful for the Court to address it in view of the substantial number of oil and gas leases on the outer continental shelf, without indicating why the issue is of any importance in this particular case. They do not assert, for example, that any spill has resulted from drilling on their leased tracts. Petitioners' failure to elaborate on the reasons why the Court should consider this choice-of-law question is understandable because, as explained below, that question had no bearing on the outcome of this case.

Petitioners raised the choice-of-law question below in connection with their contention that the Secretary's February 21 regulation governing a lessee's responsibility for oil spills was a marked departure from prior law and thereby frustrated petitioners' ability to perform under the lease. The government argued that prior to issuance of the regulations, state law, not pre-existing federal regulations, governed the standard of liability for damages to third parties

and that California law already imposed a strict standard of liability on oil drilling as an ultrahazardous activity. Thus, under the government's theory, even if the February 21 regulation established a standard of strict liability, it did not depart from prior law. Petitioners, on the other hand, argued that federal law previously governed liability for oil spills and that negligence, not strict liability, was the standard under prior federal regulations. Alternatively, petitioners argued that only oil drilling in inhabited areas was necessarily ultrahazardous under California law (Pet. App. A-14 n.12). Based on these premises, petitioners argued that the February 21 regulation changed the standard of liability (Pet. App. A-16). See generally Pet. 23, 30-33.

But whatever the law governing lessees' liability, petitioners' claim of frustration failed, as the Court of Claims properly held (Pet. App. A-18 to A-19), because petitioners had failed to prove that performance of the contract was rendered impossible by the standard of liability prevailing (or believed by petitioners to be prevailing) at the time they elected to file this action. Impossibility sufficient to enable a party to be released from his contract must be determined by an objective standard. The contract must be found unreasonable to all, not to a particular party only. See *Restatement (Second) of Contracts* § 281, Comment e (Tent. Draft No. 9, 1974); *Clark Grave Vault Co.* v. *United States*, 371 F.2d 459, 461 (Ct. Cl. 1967); 6 A. *Corbin on Contracts* § 1332 (1962). The record here reveals that other companies are and

have been since 1969 operating under existing regulations in the Santa Barbara Channel (Pet. App. A-26 to A-27; Finding 77(g), Pet. App. A-316). See also *Sun Oil Co.* v. *United States, supra*, 572 F.2d at 797-800.

In addition, the Court of Claims properly held (Pet. App. A-15 to A-18) that petitioners had failed to establish another essential element of the doctrine of frustration: the occurrence of an unexpected contingency not accounted for in negotiations between the parties. The court concluded that the state of the law on lessees' liability was plainly unsettled prior to February, 1969, whether one looked to California law, as the government urged, or to federal regulations, as petitioners suggested (*id.* A-15 to A-17). The state of the law remained unsettled even after the February 21 regulation was issued (*id.* A-17 to A-20). The Department of the Interior amended its regulations in August, 1969, less than five months after this case was filed, expressly to provide that although the lessee was responsible for cleaning up any pollutant, liability to third parties for damages caused by an oil spill was to continue to be governed by "applicable law" (Finding 76, Pet. App. A-309 to A-310). Thus, the effect of the February and August regulations, read together, was to leave the law on liability to third parties for damages exactly where it was at the time petitioners entered into their lease. Such repose can hardly be termed an "unexpected contingency" giving rise to impossibility of performance.

In sum, because petitioners failed to establish either an unexpected contingency or impossibility of performance, they would not be entitled to recovery, irrespective of the manner in which the Court might resolve petitioners' choice-of-law issue. Accordingly, there is no occasion for the Court to consider the choice-of-law issue.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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